



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

200216033

Date:

Contact Person:

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509.03-00
4940.00-00
4941.04-00
4945.04-06

Identification Number:

Telephone Number:

T: ED: B2

Legend:

P =

R =

Dear Sir or Madam:

This is in reply to your letters of April 7 and October 16, 2001, requesting rulings on P's proposed transfer of one-half of its assets to R pursuant to section 507(b)(2) of the Internal Revenue Code.

P and R are exempt from federal income tax under section 501(c)(3) of the Code and are private foundations under section 509(a) of the Code. P and R are effectively controlled by the same individuals. One of the principal directors of P has organized R to operate for charitable purposes separately from P. P will transfer approximately one-half of its assets to R. P will exercise expenditure responsibility under section 4945(h) of the Code and section 53.4945-5(c)(2) of the Foundation and Similar Excise Tax Regulations with respect to its transfer of this capital endowment to R. After the transfer, P and R will each continue to operate for exempt purposes.

The following rulings are requested:

1. P's transfer of one-half of its assets to R will qualify as a transfer under section 507(b)(2) of the Code, and will not constitute a termination of P's status as a private foundation pursuant to section 507(a) of the Code.
2. P's transfer of assets to R will not result in any tax under section 507(c) of the Code.
3. P's transfer of assets to R will not be treated as a transfer to a newly created organization.
4. P's transfer of assets to R will not be an act of self-dealing and will not subject P's foundation managers and disqualified persons with respect to P to any tax under sections 4941(a)(1) and 4941(a)(2) of the Code.
5. P's transfer to R will not give rise to net investment income and will not result in tax under section 4940 of the Code.
6. P's transfer of assets to R will not be a taxable expenditure and will not subject P to tax under section 4945 of the Code because P will exercise expenditure responsibility under section 4945(h) of the Code and section 53.4945-5(c)(2) of the regulations on its transfer of part of its assets to R.
7. P's payment of the legal, accounting, and other expenses incurred to implement the transfer will not be taxable expenditures pursuant to section 53.4945-6(b)(2) of the Foundation and Similar Excise Tax Regulations.

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Section 501(c)(3) of the Code provides for the exemption from federal income tax of nonprofit organizations organized and operated exclusively for the charitable and/or other exempt purposes stated in that section.

Section 509(a) of the Code describes organizations exempt from federal income tax under section 501(c)(3) of the Code are private foundations subject to the provisions of Chapter 42 of the Code.

Section 507(a)(1) of the Code and section 1.507-1(b)(1) of the Income Tax Regulations provide that a private foundation may voluntarily terminate its private foundation status by submitting to the Internal Revenue Service a statement of its intention to voluntarily terminate its private foundation status pursuant to section 507(a)(1) and by paying any termination tax under section 507(c) of the Code.

Section 507(c) of the Code impose excise tax on a private foundation which voluntarily terminates its private foundation status under section 507(a)(1) of the Code, and provides that this section 507(c) tax is equal to the lower of: (1) the aggregate tax benefits that have resulted from the private foundation's exempt status under section 501(c)(3) of the Code, or (2) the value of the net assets of the private foundation.

Section 507(b)(2) of the Code concerns the transfer of assets by one private foundation to one or more other private foundations, and provides that each transferee private foundation shall not be treated as a newly created organization.

Section 1.507-3(c)(1) of the regulations indicates that a transfer under section 507(b)(2) of the Code includes a transfer of assets from one private foundation to one or more other private foundations pursuant to any reorganization, including a significant disposition of 25% or more of the transferor foundation's assets.

Section 1.507-1(b)(9) of the regulations provides that a private foundation which transfers all of its net assets is not required to file annual information returns required by section 6033 of the Code for subsequent tax years after its tax year of such transfer when it has no assets or activities.

Section 1.507-3(a)(5) of the regulations provides that a transferor private foundation is required to meet its charitable distribution requirements under section 4942 of the Code, even for any tax year in which it makes a transfer of its assets to another private foundation pursuant to section 507(b)(2) of the Code. Also, where a private foundation transfers all of its assets, any recordkeeping requirements under section 4942(g)(3)(B) of the Code do not apply when the foundation has no assets.

Section 1.507-3(a)(7) of the regulations provides that, where a private foundation has transferred all of its assets to another private foundation in a transfer under section 507(b)(2) of the Code, it is not required to exercise expenditure responsibility under section 4945(h) of the Code with respect to such transfer.

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Section 1.507-3(a)(9)(i) of the regulations provides that, if a private foundation transfers assets to one or more private foundations which are effectively controlled directly or indirectly within the meaning of section 1.482-1(i)(4) of the regulations by the same persons who effectively control the transferor foundation, each transferee foundation will be treated as if it were the transferor foundation, for purposes of sections 4940 through 4948 and sections 507 through 509 of the Code. Each transferee is treated as its transferor in the proportion which the fair market value of the transferor's assets transferred to the transferee bears to the fair market value of all of the transferor's assets immediately before the transfer.

Section 1.507-3(a)(9)(ii) of the regulations provides that a transfer of assets under section 507(b)(2) of the Code does not relieve the transferor private foundation from filing its own final tax year return as required by section 6043(b) of the Code.

Section 1.507-4(b) of the regulations provides that the tax on termination of private foundation status under section 507(c) of the Code does not apply to a transfer of assets under section 507(b)(2) of the Code.

Sections 1.507-1(b)(7) and 1.507-3(d) of the regulations provide that a transferor foundation's transfer of assets under section 507(b)(2) of the Code will not constitute any termination of the transferor foundation's private foundation status under section 509(a) of the Code.

Section 4940 of the Code imposes excise tax on certain investment income of a private foundation.

Section 4941 of the Code imposes excise tax on any act of self-dealing between a private foundation and any of its disqualified persons under section 4946 of the Code.

Section 53.4946-1(a)(8) of the regulations provides that, for purposes of self-dealing under section 4941 of the Code, an exempt organization under section 501(c)(3) of the Code is not a disqualified person.

Section 4942 of the Code requires that a private foundation must expend annual qualifying distributions under section 4942(g) of the Code for the conduct of exempt purposes.

Revenue Ruling 78-387, 1978-2 C.B. 270, describes the carryover of a transferor private foundation's excess qualifying distributions under section 4942(i) of the Code where the transferor and the transferee foundations are controlled by the same persons under section 1.507-3(a)(9)(i) of the regulations. The transferee is treated as the transferor so that the transferee can reduce its own distributable amount under section 4942 of the Code by its share of the transferor foundation's excess qualifying distributions under section 4942(i) of the Code.

Section 4945 of the Code imposes excise tax on any private foundation's making of a taxable expenditure under section 4945(d) of the Code.

Sections 53.4945-6(c)(3) allows a private foundation to transfer its assets to exempt organizations under section 501(c)(3) of the Code, including private foundations, pursuant to section 507(b)(2) of the Code, without the transfers being taxable expenditures under section 4945 of the Code.

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Section 4945(d)(4) of the Code requires that, in order to avoid making a taxable expenditure, a transferor private foundation must exercise expenditure responsibility under section 4945(h) of the Code on its grants to another private foundation.

Section 4945(h) of the Code defines expenditure responsibility in terms of the grantor private foundation requiring pre-grant inquiry and post-grant reports as to the grantee private foundation on its uses of the grant. Section 4945(h) provides that the grantor private foundation must obtain proper reports from its grantee private foundation as to the grantee's uses of the grant.

Section 53.4945-5(b)(2) of the regulations provides that expenditure responsibility includes a requirement that the grantor private foundation must make a pre-grant inquiry of the prospective grantee private foundation. Thus, before making a grant, the grantor must conduct a limited inquiry of the potential grantee. Such pre-grant inquiry must be complete enough to give a reasonable person assurance that the grantee will use the grant for the proper exempt purposes. This inquiry should concern matters such as the identity, prior history, and experience of the grantee organization and its managers, and any knowledge which the grantor has, based on prior experience or other information which is readily available, concerning the management, activities, and practices of the grantee foundation. The scope of this inquiry may vary from case to case depending upon the size and purpose of the grant, the period of time over which it is to be paid, and the prior experience which the grantor has had with respect to the capacity of the grantee to use the grant for the proper purposes.

Section 53.4945-5(c)(2) of the regulations, on capital endowment grants made to private foundations, provides that, if a private foundation makes a grant to another private foundation for endowment or for other capital purposes, the grantor foundation must require reports from the grantee foundation on the uses of the principal and the income (if any) from the grant funds. The grantee must make such reports annually for its tax year in which the grant was made and for its immediately succeeding two tax years. Only if it is reasonably apparent to the grantor, before the end of such grantee's second succeeding tax year, that neither the principal nor the income from the grant funds has been used for any purpose which would result in liability for tax under section 4945(d) of the Code, may the grantor then allow the grantee's reports to be discontinued.

Section 53.4945-5(b)(3) of the regulations provides, that, in order to exercise expenditure responsibility, the grantor private foundation must require that the grantee organization be made subject to a written commitment, signed by an appropriate officer, director, or trustee of the grantee, to repay any portion of the amount granted which is not used for the purposes of the grant, to submit full and complete annual reports on the manner in which the grant funds are spent and the progress made in accomplishing the purposes of the grant, to maintain records of receipts and expenditures, and to make its books and records available to the grantor at reasonable times, and not to use any of the funds to carry on propaganda or otherwise attempt to influence legislation within section 4945(d)(1) of the Code, or to influence the outcome of any specific public election, or to carry on any voter registration drive within the meaning of section 4945(d)(2), or to make any grant which does not comply with the requirements of section 4945(d)(3) or 4945(d)(4), or to undertake any activity for any purpose other than one specified in section 170(c)(2)(B) of the Code. The agreement must clearly specify the purposes of the grant. Such purposes may include contributing for capital endowment, provided that neither the grants nor the income therefrom may be used for purposes other than those in section 170(c)(2)(B) of the Code.

Analysis

1.

Under section 507(b)(2) of the Code and section 1.507-3(c)(1) of the regulations, a transfer under section 507(b)(2) of the Code includes a transfer of assets from one private foundation to one or more other private foundations pursuant to any reorganization or liquidation, which includes any significant disposition of 25% or more of the transferor's assets. Because P will be in such a reorganization by its transfer of approximately one-half of its assets to R, P's transfer of assets to R will be a transfer under section 507(b)(2) of the Code. Under section 1.507-4(b) of the regulations, P's transfer of its assets pursuant to section 507(b)(2) of the Code will not terminate P's private foundation status under section 509(a) of the Code.

2.

Under section 1.507-4(b) of the regulations, P's transfer of its assets pursuant to section 507(b)(2) of the Code will not terminate P's private foundation status under section 509(a) of the Code and, thus, will not result in termination tax under section 507(c) of the Code.

3.

Section 507(b)(2) of the Code provides that, in a transfer of assets by one private foundation to one or more other private foundations, each transferee private foundation shall not be treated as a newly created organization. Thus, P's transfer of assets to R will not be treated as a transfer to a newly created organization.

4.

P's transfer of assets will be made for exempt purposes to R, which is an organization exempt from federal income tax under section 501(c)(3) of the Code. Under section 53.4946-1(a)(8) of the regulations, R is not a disqualified person under section 4946 of the Code for purposes of section 4941 of the Code because R is exempt from federal income tax under section 501(c)(3) of the Code. Because P's transfer of assets to R will not be a transfer to a disqualified person under section 4946 of the Code, P's transfer will not be an act of self-dealing under section 4941 of the Code.

5.

P's transfer of assets to R will not result in tax under section 4940 of the Code.

6.

P will exercise expenditure responsibility under section 4945(h) of the Code and section 53.4945-5(c)(2) of the regulations on its transfer of part of its assets to R, because the exception under section 1.507-3(a)(7) of the regulations to expenditure responsibility for a transfer of all assets does not apply to P because P's transfer to R consists of approximately one-half, rather than all, of P's assets.

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7.

Under section 53.4945-6(b)(2) of the regulations, P's reasonable legal, accounting, and other expenses, in order to make this transfer of its assets to another exempt foundation R for exempt purposes under section 501(c)(3) of the Code, will not be taxable expenditures under section 4945 of the Code.

Accordingly, we rule that:

1. P's transfer of one-half of its assets to R will qualify as a transfer under section 507(b)(2) of the Code, and will not constitute a termination of P's status as a private foundation pursuant to section 507(a) of the Code .
2. P's transfer of assets to R will not result in tax under section 507(c) of the Code.
3. P's transfer of assets to R will not be treated as a transfer to a newly created organization.
4. P's transfer of assets to R will not be an act of self-dealing and will not subject P foundation, or its managers and disqualified persons, to tax under section 4941 of the Code.
5. P's transfer of assets to R will not result in tax under section 4940 of the Code.
6. P's transfer of assets to R will not be a taxable expenditure and will not subject P to tax under section 4945 of the Code because P will exercise expenditure responsibility under section 4945(h) of the Code and section 53.4945-5(c)(2) of the regulations on its transfer of part of its assets to R.
7. P's payment of reasonable legal, accounting, and other expenses incurred to implement the transfer of assets will not be taxable expenditures pursuant to section 53.4945-6(b)(2) of the regulations.

Because this rulings letter could help to resolve any questions, please keep it in your permanent records.

This rulings letter is directed only to the organizations that requested it. Section 6110(k)(3) of the Code provides that this rulings letter may not be used or cited as precedent.

Sincerely,

(signed) Terrell M. Berkovsky

Terrell M. Berkovsky
Manager, Exempt Organizations
Technical Group 2

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